STATEMENT OF THE AMERICAN CHEMISTRY COUNCIL

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE & TRANSPORTATION

SURFACE TRANSPORTATION & MERCHANT MARINE SUBCOMMITTEE

UNITED STATES SENATE

RAILROAD COMPETITION

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EXECUTIVE SUMMARY

Safe and efficient rail service is vital for the member companies of the American Chemistry Council ("the Council"). In fact, a strong and healthy railroad industry is critical to the success and competitiveness of the chemical industry. That is why we strongly support the efforts of this committee and this Congress to provide the necessary federal resources to improve the nation's rail infrastructure. Competition between railroads, however, is just as critical, and the lack of competitive rail service options has a serious and detrimental affect on the chemical industry's ability to compete in a global marketplace.

The business of chemistry is second only to the nation's electric utilities in terms of its dependence on railroads and the size of its rail freight bill. Chemicals and plastics annually account for $5 billion in rail service provider revenues paid to transport 150 million tons of rail freight into virtually every sector of the American economy, Canada, Mexico and to various U.S. ports for export worldwide.

Nearly two-thirds (63%) of our industry's rail-served production facilities are captive to one railroad and lack competitive price quotations and service options. At captive sites, freight rates are 15% to 60% higher than freight rates at competitively served facilities, and decisions by the Surface Transportation Board ("STB") have essentially removed any incentive for railroads to respond to customer service concerns. Captivity similarly impacts solely served customer freight destinations. To make matters worse, the processes established by STB to protect captive rail shippers have proven to be inadequate. Such monopolistic behavior would not, and is not, tolerated in any other industry, and should not be tolerable in the freight rail industry. It simply runs counter to the principles of a free-market economy.

Only Congress can resolve the problems faced by rail shippers who lack competitive service, and the chemical industry urgently requests your help.

Mergers approved by STB have left the only two major carriers in the East and two in the West. Due to captivity, however, even the existence of more than one railroad in a region does not provide competition. It is clear, therefore, that the process by which rail mergers are reviewed and approved must be enhanced to safeguard against further erosion of competition between rail carriers.

On top of the diminished competition from merger approvals, certain other regulatory decisions have frustrated measures wisely enacted by Congress to correct competitive imbalances. These decisions impact important aspects of the rail industry's relations with its customers and must be examined. For example:

- **The STB has essentially precluded captive shippers from having their cars "switched" to other carriers at interchange points in terminal areas.**
- **The STB's "bottleneck" doctrine effectively blocks competition even where two railroads could each provide service over a portion of a longer route.**
- **The exclusive forum to determine "rate reasonableness" is fraught with administrative and regulatory barriers that paralyze the process and deprive captive rail customers of the protection afforded by statute.**

In conclusion, because the business of chemistry depends so heavily on railroads, we urge the Senate to promote the long-term health of the nation's railroads. We support improvements in our rail infrastructure. Equally important – as envisioned in the Staggers Rail Act of 1980 – we must allow free-market forces to operate in a truly competitive manner in the railroad industry.

STATEMENT

Good morning, Mr. Chairman and members of the Surface Transportation and Merchant Marine Subcommittee. My name is Charles E. Platz and I am the President of Basell North America Inc. ("Basell"). My business address is 2801 Centerville Road, Wilmington, Delaware 19808-1609. I serve on the Board of Directors of the American Chemistry Council ("the Council") and I am representing the Council here today.

As you know, Mr. Chairman, Basell is a proud corporate citizen of Louisiana, with production facilities in Lake Charles and Taft. I am pleased that Mr. Dan Borne, who is the president of the Louisiana Chemical Association, is accompanying me today.

Basell also produces or compounds plastics at facilities in Bayport, Texas, and Jackson, Tennessee.

Illustrating our company's dependence on rail transportation is the fact that 100% of the polymer resins we produce at Lake Charles and Bayport are loaded directly into railroad hopper cars. These operations account for the vast majority of our U.S. production. Rail is the preferred mode for shipping our product. Truck transportation is not a viable alternative. To meet the needs of our customers around the country, Basell has invested in a fleet of more than 4,000 hopper cars. Please note that Basell's entire fleet of hopper cars, which has a replacement value exceeding $260 million, is not supplied by the railroads. Instead, like many other rail shippers, Basell must provide its own specialized equipment by purchasing and/or leasing railcars.

The American Chemistry Council represents the leading companies engaged in the business of chemistry. Council members apply the science of chemistry to make innovative products and services that make people's lives better, healthier and safer. Chemicals are essential to the production of virtually every product that consumers use – computers, medicines, automobiles, cell phones, fabrics, etc. The Council is committed to improved environmental, health and safety performance through Responsible Care®, common sense advocacy designed to address major public policy issues, and health and environmental research and product testing. The business of chemistry is a $450 billion enterprise and a key element of the nation's economy. It is the nation's largest exporter, accounting for ten cents out of every dollar in U.S. exports. Chemistry companies invest more in research and development than any other business sector.

Safe and efficient rail service is crucial for the Council's member companies. For the railroads, as with every industry, competition is the key to performance. The business of chemistry is second only to the nation's electric utilities in terms of its dependence on the U.S. railroad system and the size of its rail freight bill. Chemicals and plastics annually account for

150 million tons of rail traffic, which provides the railroad industry with $5 billion in freight revenues.

On behalf of Basell and the Council, I appreciate the opportunity to address several important issues regarding the relationship between the railroads and their customers. Because Federal law governs this relationship, the Council appreciates the Subcommittee's examination of the difficulties that "captive" rail customers face on a daily basis. It is unfortunate that in a number of industries there are rail-dependent companies whose business is essentially captive to – or, if you will, monopolized by –their rail carriers. Basell is one of those companies. Today I have brought with me a number of letters from other companies engaged in the business of chemistry. Those letters are attached to this statement and I request that the Subcommittee include this correspondence in its hearing records.

Over the past several years the Council – on behalf of its members – has become increasingly concerned about the lack of direct head-to-head competition between railroads. (When two railroads compete against each other for business at a specific shipping or receiving location, it is sometimes called "rail-to-rail" competition.) But in actuality rail-to-rail competition occurs too rarely. For the Council's membership as a whole, 63% of all rail-served chemical plants in the United States are restricted to service by a single railroad. In other words, when it comes to rail transportation, nearly two-thirds of our industry is "captive" and therefore has no opportunity to obtain competitive price quotations and service options. The Council's member companies reported that their freight rates are much higher (ranging from 15% to 60% more) where one railroad has a monopoly over the shipper's traffic than where there is competition between railroads. Nor is it surprising that the Council's members find rail carriers to be less responsive to customer service concerns at the many plant locations that do not have rail-to-rail competition. In fact, in our free-market economy, competition is what drives consistent and reliable service in any industry.

I am here today because this lack of competitive rail service is damaging to the business of chemistry and increases costs to the American public. In fact, at Basell, rail transportation is our second largest cost (after feedstocks). The chemical industry's customers participate in virtually every sector of the U.S. economy – including motor vehicles, pharmaceuticals, computers, packaging, agriculture, and water treatment. We are under constant competitive pressure to supply them with our products on a cost-effective and timely basis. Moreover, as the nation's largest exporting industry, the business of chemistry also had to arrange for the movement of more than $80 billion worth of exports last year. Competing in export markets often requires rail service, either to reach customers in Canada and Mexico or to move products efficiently to various U.S. ports.

I have underscored the importance of rail service to the business of chemistry. I would now like to explain the impact of the lack of competition between railroads at so many specific locations. Some shippers face captivity where their traffic is picked up by the railroad (e.g., chemical plant, coal mine, grain elevator). For others, one railroad has a monopoly hold on the delivery point (chemical customer, electric power plant, grain processor). In many cases a specific rail movement is captive at both its origin and its destination. Even if only one end of the rail movement lacks an alternative rail service provider, competition will be affected. For example, Basell's production site is served by more than one railroad in Lake Charles. But if a particular shipment is to be delivered to one of our customers at a point that is captive to one of those railroads, in virtually no case can another railroad bid for that traffic.

In this regard, it is important to note that a captive shipper's difficulties are not alleviated if another of its own facilities is served by two competing railroads. Nor does the fact that some shippers use trucks or barges to move certain chemical products, for which those modes of transportation are feasible, somehow offset captivity for other rail-dependent shippers. To the contrary, as I will explain with reference to Basell's operations, a company with a captive production facility can even lose the benefits of the competition that exists elsewhere.

Basell is not captive at Lake Charles. But one of the railroads at that location does have a monopoly on rail service at Basell's Bayport, Texas, facility. That railroad uses its market power to obtain leverage over our Lake Charles traffic. Because of this situation, Basell and three other shippers have joined with another railroad to create competition in Bayport. We have applied to STB for permission to build and operate San Jacinto Rail Limited, a partnership whose mission is to introduce and provide competitively priced rail-service options that are sensitive to public safety and the environment. (That application is pending.) Although my company would prefer to invest in plastic resin production facilities rather than rail assets, current regulatory policies compel us to do so.

Let us begin by recognizing that such unbalanced competitive conditions were not envisioned when Congress passed the Staggers Rail Act of 1980. Indeed, that landmark legislation struck a careful balance between the needs of the railroads and the interests their customers. On paper, the law retains that balance. But two decades of regulatory decisions, first by STB's predecessor agency (the Interstate Commerce Commission) and subsequently by STB itself, have severely tilted the scales.

The Council is acutely aware that STB's exclusive authority to review rail industry mergers has left this country with so few railroads that there are now only two major railroads in the East and two in the West. As I noted earlier, the reality is that nearly two-thirds of all rail-served chemical production facilities have no competing rail service, even when another railroad has tracks within a few miles – or even closer. If the trend continues, the next round of rail mergers will almost certainly trigger successive transactions, resulting in an industry with only two major railroads in North America. With its members already subject to monopoly conditions at so many of their rail-served production facilities, the Council anticipates that the "rail merger end-game" will result in an even greater level of concentration and therefore even fewer alternatives for captive shippers.

Ideally, the next-and-likely-final round of rail mergers should be reviewed from an antitrust perspective. The Council therefore urges the Senate to elevate the involvement of the U.S. Department of Justice in the approval of rail mergers, and to make that change before further mergers are announced. Given the extreme concentration that already exists in the rail industry and the market power that railroads exert over individual captive shippers, it would certainly be appropriate to give more authority to an agency with a more balanced view of competition.

Turning from merger policy, I would like to comment on STB's governance of the on-going relationships between railroads and their customers. This is not a new topic. In fact, the laws that established STB recognize that there will inevitably be some captive rail freight customers. For that reason, Congress provided several methods to correct competitive imbalances. However, over two decades since passage of the Staggers Act, a series of agency-imposed policies have greatly weakened such provisions. Allow me to touch on just three important examples:

- Terminal Access. Some captive shipper facilities are located in "terminal areas," where two or more separate railroads maintain tracks and interchange traffic. The law (in this case, 49 U.S.C. Section 11102) permits a customer that is located in a terminal area but is captive to Railroad A to seek STB's approval to arrange for Railroad B to provide competitive long-haul service. One way to accomplish this is for the captive shipper's freight cars to be "switched" by Railroad A (the monopoly carrier) to Railroad B (the other carrier with facilities in that terminal area). Railroads regularly switch cars within terminal areas, but they oppose the use of switching as a pro-competitive alternative for captive shippers. STB, following the precedent set in the Interstate Commerce Commission's "Midtec Paper Corp." decision in 1986, has never granted captive shippers the type of competitive service that is clearly contemplated in this existing statutory remedy.

- Bottleneck Rates. Another form of relief that has been denied involves what are known as "bottleneck" situations. Captive shippers have asked Railroad C, the exclusive service provider on the monopolized portion of a rail route, to quote a rate for that specific portion only. The shipper's objective is to benefit from the competition that exists between Railroad C and Railroad D over the remaining – competitive – portion of the complete movement from origin to destination. Several years ago, STB examined this matter in a series of "bottleneck" cases. (The bottleneck is the monopolized portion of the route, which may be a small fraction of the total distance.) While nothing in the statute explicitly prevents STB from requiring Railroad C to offer a rate for its bottleneck portion of a movement, the agency has consistently refused to do so. (STB's only exception is to require Railroad C to provide a bottleneck rate in the virtually non-existent situation where the captive shipper has previously signed a rail service contract with Railroad D covering the remaining competitive portion of the movement.) Again regulators interpreted the law in a way that denies captive shippers another form of competition.

- STB "Rate Reasonableness" Procedures. Finally, the law establishes STB as the exclusive forum to resolve commercial issues arising in the rail industry. This includes STB's authorization to adjudicate the "reasonableness" of rates paid by captive rail customers. (See 49 U.S.C. Chapter 107.) A shipper must first clear a series of evidentiary hurdles to demonstrate that it is truly captive (this is known in the statute and regulations as finding that the railroad has "market dominance" for that shipper's rail traffic). Then STB is to decide the maximum reasonable rate that the captive shipper must pay to the market-dominant railroad. In reality, however, this process is vastly different than one would expect, as shown in a 1999 study by the General Accounting Office ("GAO"). STB's process actually deters shippers from using the only forum provided by Congress. GAO surveyed shippers of grain, coal, chemicals and plastics. Among the barriers identified by GAO were: STB's filing fee (raised to $61,400 as of April 8, 2002); the additional costs of lawyers and consultants; the complexity of STB's procedures; the fear of reprisal by the railroad; etc. Perhaps most telling is that 69% of the shippers surveyed by GAO believed that "STB will most likely decide on behalf of the railroads, so it is not worth our effort to file a complaint." ("Railroad Regulation: Current Issues Associated with the Rate Review Process," GAO/RCED-99-46, pages 47-51).

Basell ships approximately 14,000 carloads of plastic pellets per year. I can state that none of these three approaches – neither terminal access, nor bottleneck rates, nor STB "rate reasonableness" procedure – provide Basell with any opportunity to offset the effects of rail captivity. But in Canada, where my company also produces plastic resins and faces similar transportation circumstances, there are meaningful ways for captive shippers to negotiate with their rail service providers on a more level basis. While the Council stands ready to provide examples if the Subcommittee is interested, all I need to say today is that Canada – which is a two-railroad country – provides fair and workable mechanisms that address each of the three elements that I have just described.

In conclusion, the American Chemistry Council thanks the Surface Transportation and Merchant Marine Subcommittee for the opportunity to participate in today's hearing. Because our members depend so heavily on the railroads, we urge the Senate to pass legislation that would promote the long-term health of the nation's railroads – as envisioned in the Staggers Rail Act of 1980 – by allowing free-market forces to operate in a truly competitive manner.

The business of chemistry needs and supports a strong rail industry. In our view, the nation's rail infrastructure needs to be upgraded to carry our products and those of other critical sectors of the economy. We also applaud Senators who have already introduced or co-sponsored pro-competitive rail legislation. We look forward to working with others in Congress to re-establish the appropriate balance on the issue of rail-to-rail competition. Finally, we strongly and urgently request that this Committee address rail competition by clarifying STB's role through legislation as soon as possible.

Thank you for your interest and attention. I would be glad to answer any questions.